

Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-03

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FM AMEMBASSY TEL AVIV

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E.O. 11652: N/A

TAGS: EFIN, IS

SUBJECT: ISRAEL'S FOREIGN EXCHANGE RESERVES AND MONETARY POLICY

REF (A) 75 TEL AVIV 6584 AND PREVIOUS, (B) 74 TEL AVIV A-156

1. ISRAEL'S FOREIGN EXCHANGE RESERVES AMOUNTED TO \$1.184 BILLION ON DECEMBER 31, 1975 COMPARED TO \$1.200 BILLION ONE YEAR EARLIER (PER IMF DEFINITION REF B). RESERVES INCREASED IN FIRST QUARTER 1975 TO \$1.489 BILLION, REMAINED APPROXIMATELY LEVEL DURING SECOND QUARTER, AND THEN DECLINED UNTIL OCTOBER WHEN THEY INCREASED SLIGHTLY IN RESPONSE TO TEN PERCENT DEVALUATION OF SEPTEMBER 28. RESERVES CONTINUED TO DECLINE IN NOVEMBER AND DECEMBER, AND HAVE ALSO REPORTEDLY DECLINED IN JANUARY.

2. GOI INJECTED IL 4.250 BILLION INTO ECONOMY IN 1975, ACCORDING TO BANK OF ISRAEL (BOI) DIRECTOR-GENERAL SHEFFER IN RECENT PRESS INTERVIEW ON PRESENTATION BOI'S ANNUAL REPORT. HOWEVER, MOST OF THIS FLOW OCCURRED IN LAST EIGHT MONTHS AND WAS USED TO PURCHASE FOREIGN CURRENCY. THEREFORE MEANS OF PAYMENT INCREASED

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ONLY IL 1.833 BILLION. THUS MUCH OF MONETARY INJECTIONS'

INFLATIONARY IMPACT WAS BLUNTED.

3. COMMERCIAL BANKS' CREDIT POLICIES MORRORED GOVERNMENT'S MONETARY POLICY WITH SIGNIFICANTLY MORE FREE (CONTRASTED TO GOI DIRECTED) CREDIT OVER LAST EIGHT MONTHS. INCREASED DEMAND FOR CREDIT WAS IN LARGE PART FUNCTION OF PUBLIC'S EXPECTATION OF GREATER PROFITS IN FOREIGN CURRENCY SPECULATION. BOI REPORT SUGGESTS THAT COMMERCIAL BANKS FINANCED THIS SPECULATION AGAINST GOI'S POLICIES DESPITE THEIR GROWING LIQUIDITY SHORTAGE. FOR ITS PART, BOI INCREASED INTEREST RATES IN APPARENTLY FUTILE ATTEMPT TO MAKE SAVINGS MORE ATTRACTIVE THAN SPECULATION.

4. BEGIN LOU. COMMENT: ALTHOUGH ISRAEL'S FOREIGN EXCHANGE RESERVES AT END OF 1975 WERE ONLY SLIGHTLY BELOW COMPARABLE 1974 LEVEL, IMPORTANT DIFFERENCE IS THAT THEY ARE NOT EXPECTED TO INCREASE IN NEXT SEVERAL MONTHS. PRESENT RESERVE LEVE IS BARELY ABOVE WHAT FINANCE MINISTRY CONSIDERS TO BE CRITICAL MINIMUM AND IS ONLY MAINTAINED BY HEAVY COMMERCIAL BORROWING. IF RESERVES CONTINUE TO DECLINE, AS SEEMS LIKELY, GOI WILL HAVE TO RESORT TO DEVALUATIONS GOING BEYOND CURRENT MINI-DEVALUATIONS OF APPROXIMATELY TWO PERCENT PER MONTH.
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